United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

76-7439

To be Argued by:

JEFFREY L. ZIVYAK

UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

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P/S

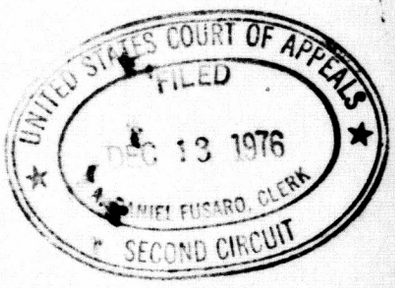
JOHN SCHLICK, individually and on behalf of all purchasers of the common stock of CONTINENTAL STEEL CORPORATION similarly situated,

Plaintiff-Appellee,

v.

PENN-DIXIE CEMENT CORPORATION, JEROME CASTLE, DANIEL H. ESCHEN, OMAR J. GLANTZ, JAMES C. JACOBSEN, HARVEY KUSHNER, ALFONSO J. MARCELLE, OLIVER K. PARRY, PAUL WINDELS, JR., GEORGE C. GREEN, ERIC M. JAVITS, JAMES F. MORRILL,

Defendants.



PENN-DIXIE INDUSTRIES, INC. (formerly Penn-Dixie Cement Corporation), JEROME CASTLE, OMAR J. GLANTZ, JAMES C. JACOBSEN, HARVEY KUSHNER, ALFONSO J. MARCELLE, JAMES F. MORRILL,

Defendants-Appellants.

ON APPEAL FROM AN ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF APPELLEE

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BRIEF OF APPELLEE

PRELIMINARY STATEMENT

This brief is submitted on behalf of the Plaintiff-Appelle, JOHN SCHLICK ("Schlick") who has, by order of The United States District Court for the Southern District of New York, dated July 26, 1976

(The Hon. Charles M. Metzner, U.S.D.J.), been designated, pursuant to Rule 23 Fed R. Civ. P., a proper representative of a class of similarly situated former shareholders of Continental Steel Corp. The Defendants-Appellants now appeal from that order.

QUESTIONS PRESENTED

1. Should this court disturb the discretionary and interlocutory order of the court below upon the mere allegation that the Plaintiff was a participant in conduct challenged in the complaint?

2. Is the order below an appealable one?

STATEMENT OF FACTS

This is the second time that this case has been before this Court and serious pre-trial discovery has not yet even begun. The complaint in this action was dismissed by the District Court for failure to state a claim. 1973 CCH Fed. Sec. L. Rep. ¶ 94,163 (S.D.N.Y.). The dismissal was reversed and the complaint reinstated by this Court. 507 F.2d 374 (2d Cir. 1974); cert. denied 421 U.S. 976 (1975).

While the facts underlying the claim for relief are set forth in Judge Oakes' opinion, supra, we have

endeavored to present a brief summary of the material allegations of the complaint. Schlick sues on his own behalf and on behalf of a class composed of all similarly situated former shareholders of Continental Steel Corporation ("Continental"). The Defendant, Penn-Dixie Cement Corporation ("Penn-Dixie"), had been the owner of 53% of Continental's voting stock. Penn-Dixie caused the circulation of proxy material soliciting the approval of the Continental minority of a Penn-Dixie - Continental merger. Eventually the transaction was completed and each share of Continental common stock in the hands of the Continental minority was forcibly converted into one and one-half shares of Penn-Dixie common stock plus a warrant to purchase a share of Penn-Dixie stock. Essentially, the complaint and the amended complaint allege that the defendants (Penn-Dixie and the men who control it) embarked upon a scheme to "squeeze out" the Continental minority by taking a series of steps which would artificially enhance the value of Penn-Dixie securities and artifically depress the value of Continental securities at the same time. Thus, when a merger would take place, the ratio of Penn-Dixie securities exchanged for Continental securities, would favor Penn-Dixie as a result of that scheme. Steps

taken included the use of Continental funds for Penn-Dixie compensating balances, improper loans from Continental to Penn-Dixie and similar abuses. (See generally the chart on Page 7 infra.) The complaint alleges that the defendants conduct was both a scheme and artifice to defraud as proscribed by SEC Rule 10b-5, and a violation of the SEC Proxy Rules.

Promptly after the reversal of the dismissal of the complaint by this Court and denial of certiorari by the Supreme Court, plaintiff moved for class action treatment pursuant to Rule 23 Fed. R. Civ. P. on July 18, 1975 (4a).* Thereafter, and on September 23, 1975, Judge Metzner referred the class motion, together with certain other motions not relevant to this appeal, to Magistrate Sol Schreiber to hear and report. After extensive briefing and oral argument, Magistrate Schreiber made his report on June 16, 1976, recommending that Schlick be given representative status. That report was, in effect, incorporated by reference in Judge Metzner's "memo endorsed" order granting the Schlick's Rule 23 motion.

This appeal raises serious and important questions

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* Numbers in parenthesis refer to pages in the Appendix.

in the still changing area of Rule 23. This Court must once again grapple with the issue of appealability; but perhaps more importantly it must deal with another roadblock in the path of representative litigation conjured up by the Defendants' bar. This latter issue, we suppose, is the contrapositive of Eisen v. Carlisle & Jacqueline, 391 F.2d 555 (2d Cir 1968). In Eisen, the defendants alleged that the plaintiff lost too little, knew too little and cared less. In this case we have quite a different situation. John Schlick understands the transactions sued upon, who can read a financial statement, who "bailed out" of the very situation sued upon as soon as he found what really was happening and who, if he had not been a captain of industry, had surely been a lieutenant. He, say the defendants, is also not a proper representative. Thus is John Schlick attacked as an inadequate class representative because he knows too much. Is this a reason to remove him as class representative?

What, does the record show? Who is John Schlick and how does he come to seek to represent the class? Mr. Schlick is a certified public accountant who, between 1943 and 1950, worked for the world famous accounting firm of Arthur Anderson & Co. In 1950, he joined U S. Plywood Corp. and stayed eighteen years, working his way up to

the position of Executive Vice-President (8a). Thus, he devoted a quarter century of his professional career to two positions. He joined Penn-Dixie in September, 1968, as Executive Vice-President for Finance and Administration and soo thereafter, was made a member of the Continental Board (8a). Nine months later he was gone, disturbed and revulsed by the defendants' method of operation (61-2a). During his brief tenure with Continental and Penn-Dixie, he voted for the continuation of a reduced-dividend policy for Continental. The chronology of events of the period is as follows: At a meeting of the Continental Board of Directors on January 21, 1969, prior to the time Schlick was a member of that Board, Continental's dividend was reduced to $.25 per quarter (172a). At the April, 1969, meeting with Schlick present at his very first meeting as a director that reduced dividend was continued (181a). Then, after Schlick's resignation, the dividend was further reduced (211a). Both the complaint and the amended complaint charge that the Continental dividend reduction was one element of the overall scheme to devalue Continental and make the Penn-Dixie-Continental merger cheaper for Penn-Dixie. Nowhere, however, can the appellants point to some knowing conduct on Schlick's part in voting for the dividend reduction as part of that scheme. If any-

thing, Schlick's activities are like those of a plaintiff in a tort action whose consent to the act sued upon was not informed. Schlick's alleged participation is at best a side bar in the overall context of the claims asserted in the complaint. The following table sets forth the acts challenged in the complaint and the time of their occurrences. They should be viewed in the frame of Schlick's nine-month tenure with the defendants which ended in June, 1969.

	EVENT	TIME	COMPLAINT REFERENCE
1)	Use of Continental Funds as Penn-Dixie Compensating Balance	1970	16(a)(i)
2)	Improper Real Estate Transaction for Continental	1970	16(a)(ii)
3)	Use of Continental Funds to pay Penn-Dixie Expenses	1970	16(a)(iii)
4)	Improper use of Continental Pension Fund	1970-72	16(c)
5)	Improper loans from Continental to Penn-Dixie	1971	16(a)(v) and (vi)
6)	Removal of Continental Funds from Continental Illinois Bank	1970	16(c)(iv)
7)	Continental Strike caused by abuse of Pension Funds	1970	16(c)(iv)

EVENT	TIME	COMPLAINT REFERENCE
8) Reduction of Continental Dividends	1968-72	16(d)
9) Failure to amortize Continental Acquisition costs	1970-72	21(a)
10) Failure to pay interest to Continental for use of funds as compensation balances	1970-72	21(b)
11) Improper accounting treatment of Penn-Dixie earnings derived from Continental	1970-72	21(f)
12) Bond repurchase to artifically increase Penn-Dixie earnings	1972	21(g)

Yet Appellants contend that Mr. Schlick's brush with one of the transactions sued upon, bars him from representing a class.

When this was raised below, Magistrate Schreiber wrote (237-9a)

> Defendants would have the court conclude that since, at the trial, Schlick may be held liable to the class of Continental shareholders for one of the unlawful acts alleged in the complaint, namely, the scheme to depress the price of Continental stock, he is disqualified from representing the class of Continental shareholders in this action. This argument is not persuasive. In the first place, it is far from certain at this stage of the case that Schlick will be held liable to the class for any activities in relation to the alleged scheme to depress the price of Continental shares. Insofar as this scheme is concerned,

it would appear that the major act in the effectuation of the alleged scheme was the resolution by the Continental Board in January 1969 which lowered the Continental dividend from $.80 to $.25. Schlick was not a member of the Continental Board of Directors in January 1969 and no showing has been made that Schlick played any role in that drastic reduction of the Continental dividend.

Defendants emphasize that at the April 15, 1969 meeting of the Continental Board, Schlick voted to continue in effect the 'depressed' $.25 dividend even though he knew that a higher dividend ought to have been declared. (Transcript of Schlick's Deposition, p. 47). It is Schlick's contention, however, that his vote at the April 15, 1969 meeting was not motivated by any antipathy toward the Continental shareholders, but rather was prompted by pressure exerted by defendant Jerome Castle to insure that all resolutions of the Continental Board were unanimous. Schlick claims that it was such conduct on the part of Castle and others which caused his speedy withdrawal from the directorates of both Penn-Dixie and Continental and furnished him with the requisite personal interest to bring this suit. (Transcript of Schlick's Deposition,pp. 46-47).

Whether or not Schlick's vote at the April 15, 1969 meeting of the Continental Board is sufficient to render him liable to the class of Continental shareholders is a matter which should await trial. At this stage of the case defendants' argument, while not frivolous, is nonetheless based on speculation and the mere possibility that at trial Schlick's conduct as a director of Continental may render him liable to the class he is representing.

The potential liability of the proposed class representative to the class he seeks to represent is not an automatic bar to the maintenance of the class action. As long as the requirements of Rule 23 are met, the action mayproceed as a class action.

These are the issues on this appeal. What the appellants ask is that an appellate court predict that a class

representative will proceed in a less than vigorous way and based on that prediction strip away class status. We submit that this type of precognition or extrasensory perception is not called for. Rule 23 charges the district court with the duty to monitor the vigor of prosecution of a class action. There is no reason to assume that the duty will be shirked.

POINT I

THE DECISION OF THE COURT BELOW WAS CORRECT AND SHOULD BE LEFT UNDISTURBED

Whatever epithets may be hurled, it is clear that the appellants are attempting to embroider a rather narrow strip of cloth. The applicable law, even including those cases in which class status was denied, assist Schlick, not Penn-Dixie and the other appellants.

Lamb v. United Security Life Company, 59 F.R.D. 25 (S.D. Iowa 1972) is strikingly similar to the case at bar. It was also a securities class action. The defendants opposed a Rule 23 motion on the ground that the proposed class representative was, like Schlick, a director of the merged-out corporation, whose "squeezed out" former shareholders composed the proposed class. The plaintiff had gone so far as to have voted ". . .for the several resolutions which effected the exchange ...

and the subsequent merger ..." Id. at 30. Thus, in Lamb, unlike the case at bar, the proposed former class representative was an insider who had participated in the very transactions challenged in the complaint. Here, despite the artful arguments of the appellants, it is clear that Schlick had at best a tangential relationship with the transactions challenged. In granting the Rule 23 motion in Lamb, the Court stated:

> "It appears to the court that, notwithstanding the fact that Mr. Seale (the former director) was a director, there are sufficient allegations that he was a victim of fraud and misrepresentations not distinct from the rest of the shareholders. He asserts his interests here in that capacity. His personal liability, if any, might be relevant in a derivative action, precluding his participation as a plaintiff therein, but the court cannot see anything in Mr. Seal's former status at this time antagonistic to or in conflict with other sought to be included in the class, although he might eventually, upon trial of this cause, be defeated upon his individual claim by reason of that status, just as other plaintiffs may be individually defeated by other defenses. Concededly, Mr. Seale is not the average uninformed investor, but this does not require either the conclusion that he cannot protect and vigorously assert the interests of others in the class, or that his interest in redress of the fraud and misrepresentation alleged is not identical to those he seeks to represent." (Footnote omitted)

We turn to Maynard, Merel & Co. v. Carcipoppullo, 51 F.R.D. 273 (S.D.N.Y. 1970), a case which is one of the few denying class status. It is, however, most helpful to Schlick by virtue of the legal principles it

espouses. In Maynard, the moving party seeking class designation had been the underwriter of a public offering of the stock of a company which was being "merged out". As a result of the merger, the plaintiff lost a "right of first refusal" to underwrite any prospective public offering of the merged-out company. This right of first refusal which the proposed class representative was seeking to protect by compelling rescission of the merger differentiated it substantially from other "merged out" potential class members who obviously would be satisfied with money damages if it were judicially determined that the merger was improper. Thus, in denying the Rule 23 motion, Judge Mansfield wrote:

> Even if the complaint were amended as plaintiffs request, it does not appear that plaintiffs would fairly and adequately protect the interests of the class which they seek to represent, i.e., the other Carci shareholders at the time of the merger. Their interests are potentially adverse to those of the other class members in that the harm which they have suffered from the merger is unlike that of any Carci shareholder and consequently the relief they most desire (rescission) might not be satisfactory to the others. For services rendered in the Carci public offering of June 1969, both plaintiffs received, in addition to substantial cash and stock commissions, rights of first refusal with respect to underwriting of future public offerings of Carci. In addition, Sealfon received a financial consulting fee and the right to designate one director of Carci. Since the rights of first refusal and the one Carci directorship have not survived the merger of Carci into Cybermatics, the onlyway Merel and Sealfon can avoid losing them is by obtaining a mandatory injunction to undo the merger which they now seek. Their paramount interest in undoing the merger or in liquidating through other means the rights which they are threatened with losing creates a high potential for conflict with the interests of the other members of the class.

> Specifically, they are less likely than other former Carci shareholders to accept the offer of a cash settlement, even though such a settlement might be desired by other class members and in fact, be in the best interests of the class." (Emphasis added)

Here on the other hand, Schlick's primary interest is coextensive with the class he proposes to represent; that is to seek money damages for himself and similar money damages for absent class members. The conflict apparent on the face of Maynard simply does not exist here and that case bolsters Schlick's position.

In First American Corporation v. Foster, 51 F.R.D. 248 (N.D. Ga. 1970), a Rule 10b-5 class action was brought by former officers of the subject corporation. It appears that the plaintiffs had been ousted from management after an internal struggle. Hence, their Rule 23 motion was opposed because of their former association:

> In granting the motion, the Court wrote:
>
> Defendants' allegation of an antagonism between plaintiffs and other class members standing alone is not enough to require that the action not be allowed to proceed as a class action. Such antagonism must be as to the subject matter of the suit." Id. at 250.

Thus, reading Lamb, Maynard and First American together, we learn that the antagonism or conflict which would defeat a Rule 23 motion can be defined as difference in goals of the litigation as between the proposed class

representative and the absent class members. This case clearly demonstrates that no such conflict exists, since Schlick seeks relief (i.e. money damages) which is qualitatively identical to the relief sought on behalf of the class. Unlike Maynard, but like Lamb and First American, the plaintiff receives no special benefit from recovery which makes it different from absent class members.

As many cases have observed, there is something disingenuous about defendants' opposition to a Rule 23 motion on the grounds that representation will be inadequate or that the requisite vigor will not be present. Upon analysis, defendants are saying "don't let this man represent a class because he won't get a big enough judgment or a favorable enough settlement". See Umbriac v. American Snacks, Inc., 388 F. Supp. 265 (E.D. Pa. 1975); Madonick v. Denison Mines Ltd., 63 F.R.D. 657 (S.D.N.Y. 1974).

This case, unfortunately, is not the first one in which such opposition was firmly grounded in nothing more than attempted character assassination. In the court below, the thrust of appellants' argument was that Schlick was an evil, venal man who should not represent a class. That didn't win and now appellants argue that he will be sloppy and slothful and thus should not be a class

representative. That may be a difference in degree, but it is not one in kind; it is still character assassination. That was the tactic adopted in Cook Investment Co. v. Harvey, ¶95, 203 CCH Fed. Sec. L. Rep. (N.D. Ohio 1975).

Judge Walinski's words in rejecting such an argument are all too applicable here:

> Defendants' principal argument seems to be that the plaintiffs will not fairly and adequately protect the interests of the class. Although defendants have filed several briefs on this motion, the court has had considerable difficulty in discerning the nub of their argument that plaintiffs are not proper representatives of the class. Unfortunately, the court feels constrained to concur with plaintiffs that many of defendants' contentions amount to an argumentum ad hominem. Although, by its very nature,an argument attacking a plaintiff as an inadequate representative of a class is some thing of an argumentum ad hominem, this kind of dialetic requires something more than mere 'poisoning the well'. Once a plaintiff has shown the requisite stake in the outcome and that counsel is competent to conduct class action litigation, it is incumbent upon those opposing the class action to show how a plaintiff will not adequately protect the interests of the class. Defendants herein have made several accusations even if true somehow disable the plaintiff . . . from representing the class. The court thus finds it very distressing that so much verbiage sheds so little light on an issue...Even assuming that all of these contentions are true, it is difficult for this court to understand how they disable plaintiff . . . from being the class representative in the face of his ownership of 100 shares of stock and plaintiffs' counsel's apparent expertise in class litigation."

In Dorfman v. First Boston Corp., 62 F.R.D. 466 (E.D. Pa. 1974), the motive of one of the proposed class representatives was questioned. The plaintiff had retained eight of its original 600 debentures "as a matter of

principle . . . to see this action through." Id. at 473. Defendants urged that the proposed representative was being vengeful.

In rejecting defendants' arguments concerning the efficacy of the proposed class action, Judge Lord said,

> ". . .principle coupled with the hope of rectifying a claimed loss and the prospect of a substantial recovery, may be as strong a spur to vigorous prosectuion as many other motivations." Ibid.

One need only look at the nature of the inquiries made at Mr. Schlick's deposition to understand that the opposition to representative status is as Judge Walinski noted, an argument ad hominem. While you were employed by the defendant, how often did you play golf, Mr. Schlick? (146a). Did you bet on the outcome of football games? (148a)? Didyou go to Las Vegas and gamble there? (92a). Did your wife accompany you on the company plan? (92a)? Did you bet on the horses? Isn't this disingenuous? Does it not establish why the appellants are pursuing this appeal? They must disqualify Schlick or eventually the truth will out and the former Continental minority will finally be paid what their stock was worth.

A synthesis of the applicable law reveals that a proposed class representative will not be disqualified simply because he has a more intimate knowledge of the corpora-

tion's inner workings as Schlick obviously does. Indeed, does this not make him a better class representative? Mersay v. First Republic Corp., 43 F.R.D. 465 (S.D.N.Y. 1968); see also Reichlin v. Wolfson, 47 F.R.D. 537 (S.D.N.Y. 1969). Hypothetical liability resting against the plaintiff or his motive for bringing the suit will not defeat the motion. Vernon J. Rockler & Co. v. Graphic Enterprises, Inc. 52 F.R.D. 335 (D. Minn. 1971); First American Corp. v. Foster, supra.

The test then is whether the class representative's departure from the norm of the absent class member is such that he will not vigorously pursue the rights of those absent class members. It is submitted that a simple review of the docket sheet in this case and a look at Volume 507 of the Federal Reporter demonstrates the vigor of plaintiff's prosecution of this action. Nothing more need be said in this regard.

We also point to the position taken by many Courts in similar situations. See Dorfman v. First Boston Corp., supra; in re Goldchip Funding Co., 61 F.R.D. 592 (E.D. Pa. 1974). A District Court has the power to review its orders in a class action at any time during its pendency pursuant to Rule 23(d)(2).

This was the view taken by Magistrate Schreiber when he wrote:

> In addition, there are no present conflicts of interest between Schlick and the class which will prevent Schlick from fairly and adequately representing the class. Should such a conflict of interest appear at any point in the litigation, the court is empowered, pursuant to Rule 23(c)(1), to alter or amend the order granting class action certification. Such a procedure is clearly preferable to striking the class allegations at the outset, when the alleged conflict between plaintiff and the class is speculative at best. Federman v. Empire Fire & Marine Insurance Co. supra at 483.

We suppose that the one genuine area of concern that the appellants have raised is the area of the relationship of class actions, procedural due process and res judicata. The appellants are indeed entitled to know that if they win, their victory will bind absent class members.

Since Schlick, they assert, will not vigorously pursue the class claim, any defendants' victory at trial will be hollow since the procedural due process requirements of Hansberry v. Lee, 311 U.S. 32 (1940) would permit the entire case to be relitigated. An appealing argument, but one which simply does not survive the light of day.

Class treatment should not be denied because there is some arguable possibility of lack of vigor in futuro. It is in the peculiar province of the trial court to monitor the vigor of class representation.

The framework in which the district court operates is fully spelled out in Rule 23 itself. "An order under this subdivision may be conditional and may be altered

or amended before the decision on the merits." Fed R. Civ. P. 23(c)(1). Any modification of such a class action order can be made either after the district court's own observation of how the action is being pursued or after the district court has polled absent class members.

Thus, while the granting of a Rule 23(c) motion subsumes a finding that the plaintiff will fairly, adequately and vigorously represent the class, subsequent notice to the class polling them as to the vitality of their representative's actions is one way of complying with the requirements of procedural due process. Thus, the Advisory Committee for the 1966 amendments to the Federal Rules of Civil Procedure, wrote:

> This mandatory notice pursuant to subdivision (c)(2), together with any discretionary notice which the court may find it advisable to give under subdivision (d)(2) is designated to fulfill requirements of due process to which the class action procedure is of course subject. Reported at 39 F.R.D. at 107.

We suggest that there is a well-trod path to follow here which will safeguard the due process rights of absent class members. The order below should be affirmed and the requisite notices pursuant to Fed. R. Civ. P. 23 (c)(2) should be given. As noted above, the class action determinations are conditional and may be altered or amended in accordance with Rule 23(c)(1). In a case such as this one, the plaintiff should be given the

opportunity to show that he will be an adequate class representative.

In Dorfman v. First Boston Corp., supra, the defendants objected to the proposed class representatives on grounds not unlike the ones raised here.

After granting the Rule 23(c) motion, the Court wrote, at 474:

> Although we have concluded that [plaintiffs] will fairly and adequately represent the class, it is important to emphasize that, if at any time it appears that the quality of the representation is less than satisfactory, we are empowered under Rule 23 (d)(2) to give the members of the class an opportunity to signify whether they consider the representation fair and adequate, we shall exercise that power if it becomes necessary to do so.

Similarly, in Sanders v. Nuveen & Co., Inc., 463 F. 2d 1075 (7th Cir. 1972), cert. den. 409 U.S. 1009, the Court discussed intervention rights in class actions and stated:

> The portions of Rule 23(d) pertaining to intervention in class actions are intended to strengthen the adequacy of representation of the class. The Advisory Committee's Note to Rule 23 emphasizes 'Subdivision (d) is concerned with the fair and efficient conduct of the action' through supplementary notice to members of the class and by strengthening the class where necessary. (Footnotes omitted)

The Court disapproved the intervention permitted by the Court below and wrote:

> The purpose of the mandatory notice and disclosure requirements of Rule 23(c)(2) is to advise all class members of their rights and privileges under the close supervision of the court.

> This is not to say that the [intervenors] could not intervene under any circumstances. Once the court has determined whether the plaintiff's suggested class satisfies the requirements of Rule 23(c) and (b)(3), and once members are notified under Rule 23(c)(2), the [intervenors] may seek to intervene under Rule 24(a)(2). They would petition not as representatives of the plaintiff's class, but as applicants who claim 'an interest relating to the property or transaction which is the subject of the action and are so situated that the disposition of the action may as a practical matter impair or impede their ability to protect that interest . . .' At that point, the court may determine that the members of plaintiff's class are entitled to supplementary notice under Rule 23(d)(2). If the [intervenors] seek to intervene under those circumstances, Rule 24(c) and sound judicial administration require that their motion to intervene shall state the grounds therefor and shall be accompanied by a pleading setting forth the claim or defense for which intervention is sought.' The pleading should be one of those described in Fed. R. Civ. P. 7(a) so that all parties understand the position, claims and nature of relief sought by the prospective intervenors.
>
> Once the due process requirements of Rule 23 are satisfied by full and fair notice to all members of any class or classes or subclass or subclasses determined by the court may then 'make appropriate orders . . . determining the course of proceedings.' (at 1082, footnote omitted).

We turn then to the cases relied upon by the appellants. They rely perhaps most heavily upon G.A. Enterprises, Inc. v. Leisure Living Communities, Inc. 517 F.2d 24 (1st Cir. 1975). That case is totally distinguishable from the case at bar. In G.A. Enterprises, a derivative action was brought and the proposed representative plaintiff was found by the District Court to be unable to fairly and adequately represent the interests

it sought to represent.

The facts in that case are most enlightening. One Katter was the principal of the proposed representative plaintiff and the Court described the relationship among Katter, G.A. Enterprises and Leisure Living as follows:

> Katter, who besides controlling GA also controls other companies, had in 1970 entered into complex business arrangements encompassing the sale of various Katter controlled entities and assets to Leisure Living. That arrangement soon turned sour spawning litigation between Katter and his companies, on the one hand, and Leisure Living on the other. A Katter company other than GA has sued Leisure Living for liquidated damages and equitable relief upon an agreement by Leisure Living to pay that company $50,000 a year plus an option on 20,000 shares of stock. Leisure Living had itself sued a second Katter-controlled corporation in the District of Maine, and was awarded a judgment (recently affirmed by this court) for $240,000 plus interest. A trustee attachment and preliminary injunction against still another Katter-controlled enterprise was obtained by Leisure Living in Massachusetts to secure satisfaction of that judgment. Other cross-claims and obligations exist." Id. at 25.

Judge Campbell, speaking for the First Circuit, then quoted from the District Court's opinion as follows:

> all the claims taken together are sufficiently adverse to the interests of the shareholders to require dismissal of the action. It is the totality of the relationship between the Katter companies and Leisure Living which mandates this conclusion. Were there simply one pending suit between the parties it is quite possible that the same result would not obtain. The Court is fearful that, given the complex business arrange-

> ments involved, this suit, as one of several between the parties, runs the risk of losing its special character as a derivative suit." Id. at 26.
>
> Judge Campbell then went on to state:
>
> GA's own interests, or at least the interests of its principal, suggest that from its standpoint the 'highest and best' use of the derivative suit would be as a weapon in the total Katter arsenal, to be either pursued, de-emphasized, or settled as the future course of the larger claim might dictate. Since the suit threatens Leisure Living's managers with individual liability, it provides leverage that could affect how doggedly they pursue Leisure Living's own claims and defense against Katter in other areas. So manipulated, the derivative suit would serve interests beyond ahd perhaps contrary to those of the other minority stockholders." (Emphasis added, footnote omitted)

Thus, it is clear that what concerned the Court in G.A. Enterprises and what prompted the Court to affirm the denial of representative status was that the reason for the seeking of representative status was not the reason found on the face of the complaint -- there was an ulterior motive. Such a finding was entirely consistent with the state of the facts prior to the commencement of the derivative action in G.A. Enterprises. This is to be contrasted with the facts here. Simply stated, Schlick wants precisely what the complaint says he wants, damages for himself and the class he represents.

This is also the basis for distinguishing Hornreich v. Plant Industries, Inc., 535 F. 2d 550 (9th Cir. 1976) from the case at bar. Once again in Hornreich the

derivative suit was but one of a series of pending litigations and was (at least in the view of the Court of Appeals) being used as a weapon in an internal corporate dispute. Neither G.A. Enterprises nor Hornreich is thus applicable to thecase at bar.

Equally distinguishable is Gonzales v. Cassidy, 474 F. 2d 67 (5th Cir. 1973). That case simply holds that a prior class action will not bind absent class members when a post hoc review of the record reveals that the class representative did not do an adequate job of representing absent class members. This is nothing new, the vexing problem of avoiding duplicative lawsuits, while protecting individual rights has been around for some time, at least since the English Equity Bill of Peace:

> To bring actions against every individual...is regarded as perfectly impracticable. Therefore a bill is filed to establish that right; and it is not necessary to bring all the individuals: why? Not, that it is inexpedient but, that it is impracticable to bring them all. The Court therefore has required so many that it can be justly said they will fairly and honestly try the legal right between themselves, all other persons interested and the Plaintiff. Lord Eldon in Adair v. New River Co. [Chancery 1805] 32 Eng. Rep. 1153.

How representative parties act for others has concerned courts for a very long time; but they have not before nor should they now be asked to

speculate on how good representation will be because there is some allegation that the class representative will be less than vigorous.

The policy of Rule 23 is ill served by disqualifying someone like Schlick from representative status.

We have a proposed class representative who has a real loss and who can make a meaningful contribution to the conduct of the litigation. Obviously the more sophisticated the investor or the closer to the situation the representative was, the more likely it is that he be subject to attack through the counterclaim device or through the claim of atypicality. The sophisticated investor or the former insider is more likely to have made an independent investigation of the subject matter of the suit; he is more likely to have had direct contact with the defendants. This is the kind of class representative who should be encouraged because he is a bonafide litigant and not the straw man attacked with such zeal in Eisen.

John Schlick is an adequate class representative. The decision of the court below should be affirmed.

POINT II

THE ORDER BELOW IS NOT APPEALABLE AND THIS APPEAL SHOULD BE DISMISSED

This court lacks subject matter jurisdiction over this appeal. The order below was not a final judgment. Under the final judgment rule, 28 U.S.C. §1291, only final orders are appealable absent certification pursuant to 28 U.S.C. §1292(b). The law is that the granting of a motion for class status is an interlocutory order which, unless certified or coming within the limited exceptions to this statutory rule, may not be appealed. Parkinson v. April Industries, 520 F. 2d 650 (2d Cir. 1975); 7 A Wright and Miller, Federal Practice and Procedure §1802 (1972).

It should be noted that appellants sought interlocutory certification pursuant to 28 U.S.C. 1292(b) but such relief was denied on September 15, 1976. Appellee then moved to dismiss this appeal for want of subject matter jurisdiction. That motion was "denied without prejudice to renewal to the panel hearing the appeal."

This court's most recent pronouncement on the appealability of class actions is Parkinson v. April Industries, supra. That case posited a three prong test for appealability as follows:

(1) whether the class action determination is

> 'fundamental to the further conduct of the case';
>
> (2) whether review of that order is "separable from the merits';
>
> (3) whether the order will cause 'irreparable harm to the defendant in terms of time and money spent in defending a huge class action'.

The court in turn synthesized the holdings of both General Motors Corporation v. City of New York, 501 F. 2d 639 (2d. Cir. 1974) and Kohn v. Royall, Koegel & Wells, 496 F. 2d 1094 (2d Cir. 1974). Thus, this Court wrote in Parkinson:

> Our court in General Motors recognized that an appellant would not be able to satisfy the three-pronged test for an immediate interlocutory appeal if he only questioned the propriety of the discretionary ruling of a trial judge that the requirements of Rule 23(b)(3) had been met. April here argued only that plaintiffs failed to establish that there is sufficient merit in the plaintiffs' complaint for the plaintiffs to act as class representatives, that there is insufficient indication that the class is so numerous that joinder of all its members is impracticable, and that common questions do not discretionary ruling of the district judge that the prerequisites of Rule 23(a) and the requirements of Rule 23(b)(3) have been satisfied. This ruling is far from being an "unprecedented and extraordinary" one, and we are not called upon to review a finite and conclusive determination of judicial power. General Motors, supra, 501 F. 2d at 647.
>
> We therefore dismiss the appeal.

What both Judge Waterman in the majority opinion and Judge Friendly in his concurring opinion were obviously striving for was a standard of appealability which would

deny review to all class actions orders except those which deal with matters outside the four corners of the rule.

In the appeal at bar, we are, like the Parkinson case, dealing simply with the exercise of a District Court's discretion concerning the presence of all of the elements of a class action. The District Court has simply found that the prerequisites of Rule 23(a) and 23(b)(3) have been met. This is therefore a "routine" class action determination and it should not be reviewed. Indeed what jurisdiction is there here to make such a review.

Applying one of the three Parkinson "prongs", appealability is specifically found wanting. This appeal must, in order to resolve the questions raised by the appellants, delve into the merits. Thus if Schlick was, as the appellants allege, a participant in an unlawful scheme must not a finding necessarily be made that there was a scheme in the first place? This is naturally an inquiry into the merits.

It is the settled law of this Court that where review of a class action designation would require the appellate court to inquire into the merits of the case, an appeal will not lie. Kohn v. Royall Koegel & Wells, supra, 496 F. 2d at 1100; General Motors Corp. v. City

of New York, supra, 501 F. 2d at 645. Handwerker v. Ginsberg 519 F. 2d 1339 (2d Cir. 1975).

Thus, in Kohn, appellant claimed that the appellee would not adequately represent the class because unlike some of its purported members, she was not a present employee. This court found that the raising of such an issue was not appealable because "were we to permit interlocutory review, we would be forced to delve into an issue ... which is inextricably intertwined with the ultimate merits of Kohn's claim for relief". 496 F. 2d at 1100. In General Motors, review was found to entail a consideration of the merits because it would involve the task of product and geographic market definition, simply to determine whether evidence submitted in this definitional process would be common or individual in nature. In Handwerger, a securities fraud action, review was impermissible because the court "would have to decide whether appellee is barred as a matter of law from recovering on his substantive claim" 519 F. 2d at 1341.

This, too, is the situation at bar. If Schlick improperly participated in the cutting of the Continental dividend, so did the other defendants and that is an inquiry into the merits.

This court is without jurisdiction of this appeal.

CONCLUSION

FOR ALL THE REASONS SET FORTH ABOVE, THE DECISION AND ORDER OF THE COURT BELOW SHOULD BE AFFIRMED.

Respectfully submitted

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John Schlick

Dated: December 13, 1976.

From COPIES RECEIVED (two for each)

FRIED, FRANK, HARRIS, SHRIVER
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By Phillip Goldstein

December 13, 1976

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